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Tax Revenue Targeting as the Anchor for Tax Reform

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Commentary
More on Tax Reform
Tax revenue targeting as the anchor/or tax reform

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by Evan Richert

In the debate about Maine's tax structure; four deficiencies regularly come to the forefront:

- We rely too heavily on property taxes. In 1966, property taxes were an estimated 44 percent of revenues from the "big three" taxes—sales, income, and property. Ideally, property taxes would be closer to a third of those total revenues.
- Tax revenues are too volatile. Tax revenues increased 1.5 to 3.0 times faster than income during the 1980s, a period of economic growth, and fell nearly 4.0 times faster than income during the 1991 recession. Ideally, the elasticity of revenue compared to income would be in the1.0 to 1.2 range.
- Overall tax burden is too high. Based on 1996 data for state taxes and 1994 data for local taxes, Maine has the eighth-highest burden nationally. This is the result, as Christopher St. James notes, of being relatively poorer in personal income than most states but choosing "to tax ourselves higher to buy government services like education, health care, and corrections more comparable to those in richer states."
- The tax burden is not fairly distributed. While Maine's tax structure is one of the most progressive in the nation, the bottom quintile of the state's non-elderly, married-couple households still pay a higher share (11.6 percent) of income to state and local taxes than any other income group.

Some of these problems are positively linked to each other. That is, solving one problem will help solve another. For example, over-reliance on the property tax is positively correlated with a disproportionate burden on the working poor. A shift away from the property tax to a more progressive tax, such as on income, would ease both problems. But others are negatively linked; solving one makes another worse. This is especially true of the connection between the stability and the progressivity of the tax structure. The most stable tax structure tends to be the least progressive, and the most progressive tax structure tends to be the least stable. For example, the most stable tax structure would include taxes on essentials, such as food, the purchase of which neither increases nor decreases precipitously during good and bad economic times. But taxing essential stakes disproportionately from low- and moderate-income households.

This creates a monumental challenge to tax reformers. They cannot maximize all the "good" things we'd like out of a tax structure, like progressivity and stability, because maximizing one will tend to minimize another. Difficult choices must be made as to which goals are most important. In the past, Maine has chosen fairness over stability, employing a steeply progressive income tax and a narrowly based sales tax to raise state revenues. As we discovered during the first half of the1990s, this leaves the state dangerously vulnerable during economic down turns.

At the same time, a virtually complete reliance on the property tax for local revenues has diluted the progressiveness of the overall system, leaving the state short of the goal of tax fairness even after seriously sacrificing stability.

The political tendency in situations in which equally admirable goals are opposed to each other is to compromise—to find a solution that falls short of any single goal but reasonably satisfies all of them. Finding such an optimal arrangement will be much easier if:

- The overall tax burden is reduced. Problems like revenue instability and tax regressivity are magnified when overall burdens are too high. If tax burdens were low, middle- and upper-income households would more willingly accept a greater burden to enhance fairness, while low-income house holds would more willingly accept taxes on some essentials to achieve greater stability in revenues (and, hence, in the governmental programs that assist them). But when tax burdens are high, few are willing to cede their positions. Rather, each tends toward single-minded solutions, like tax caps, that would maximize one goal without regard to the others.
- A mechanism is found to introduce stability in a way that does not counteract progressivity. The mechanism is self-discipline—resisting the urge to spend the surplus during good economic times so there will be a hedge against bad economic times.

The vehicle proposed by Governor Angus S. King to lay the foundation of lower tax burden and self-discipline is called tax revenue targeting. The Legislature's Taxation Committee carried over for debate during the second session of the 118th Legislature a bill (LD 1824) that would implement tax revenue targeting. This system would require the governor and Legislature, in consultation with local governments, to establish biannually the maximum share of the state's total personal income that could be captured by state and local taxes. Tax revenues received in excess of the limit would be placed into the Rainy Day Fund, directed toward unfulfilled obligations of the state to local government, or returned to tax payers. The need for tax revenue targeting rises out of the experience of the last ten years and the volatiles, of the state's tax structure. From 1985 co 1995, total personal income in Maine; grew by 76 percent. During the same period, revenues from all state and local taxes increased 108percent, or 1.4 times faster than income. As a result, the tax burden increased from10.7 percent to 12.7 percent of total personal income—the equivalent of a half-billion additional tax dollars—and that has fostered predictable reactions.

The need for tax revenue targeting rises out of the last ten years of violation of the states tax structure. From 1985 to 1995, total personal income in Maine grew by 76 percent, or 1.4 times faster than income. As a result, the tax burden increased from 10.7 percent to 12.7 percent of total personal income-the equivalent of a half-billion additional tax dollars-and that has fostered predictable reactions.

Tax revenue targeting is not the full answer to tax reform, but it should be its anchor. Once in place, the political process will be much freer to find its way to some optimal combination of the "good" things we'd like out of the state's tax structure, balancing the important goals of fairness, stability, and equitable tax mix.

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